UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

BKY No. 04-41707

In re:

Daniel J. Simon,

Debtor(s).

MEMORANDUM IN SUPPORT OF OBJECTION OF FULLER, SEAVER & RAMETTE, P.A. TO PLAN CONFIRMATION, AND MOTION FOR CONVERSION

FACTUAL BACKGROUND

The Debtor filed a Chapter 7 petition on March 30, 2004. In his schedules, he listed $1,000 per month in gross estimated income. The Debtor's statement of financial affairs, at item 1, stated that he had "$2,500 2004 YTD Est. gross." His Schedule B disclosed no rights to commissions. On July 7, 2004, the Debtor received a discharge. On August 6, 2004, an order was entered approving the Rule 2004 examination of the Debtor.

On September 22, 2004, the Rule 2004 examination of the Debtor was conducted. That examination established that the time the Debtor filed his bankruptcy petition, he was entitled to various first year commissions and renewal commissions on life insurance and other insurance policies sold pre-petition ("Pre-petition Policies")

The Debtor's rights to those commissions for Pre-petition Policies ("Commissions") were not disclosed in his Schedule B.

Rather than the $1,000 disclosed in his Schedule I, the Debtor's gross income in the January - March was at least as follows:

January	$3,577
February	$3,973
March	$3,956

Seaver Aff. Ex. 2 at Ex. 10 thereto.

Rather than the $2,500 YTD which the Debtor disclosed, he had over $10,000 gross ytd when he filed.

His post-petition gross income for April - August was at least:

April $4,258.69
May $2,932.26
June $4,047.74
July $2,691.03
August $3,506.54

Seaver Aff. Ex. 2 at Ex. 10 thereto.

His average post-petition monthly gross income is about $3,487.

Through non-disclosure of his commission rights to Pre-petition Policies, and his false statements as to gross income at Schedule I and at Item 1 of the statement of financial affairs, the Debtor concealed his true amount of gross income and the source of that income.

Since the commencement of the bankruptcy proceeding through September, 2004, the Debtor has apparently received $11,132.32 in Commissions from Continental General on account of Pre-petition Policies. He has turned none of those monies over to the Trustee.

Since the commencement of the bankruptcy proceeding through September, 2004, the Debtor received over $7,800 in Commissions from Fidelity and Guaranty Life Insurance Company which are, upon information and belief, on account of Pre-petition Policies. He turned none of those monies over to the Trustee.

At the conclusion of that Rule 2004 examination, the following exchange occurred:

> MR. SEAVER: Well, I want to make sure this is on the record. Mr. Andresen, these commissions I believe are all property of this bankruptcy estate,

I have several cases here that I will give you to that affect, one of them being a 2001 case out of North Dakota it's in re: Swanson decided in December of 2001. I am concerned that those renewal commissions weren't ever disclosed, I believe that the taking of those renewal commissions and commissions on first year policies written pre-petition are all property of the bankruptcy estate and that Mr. Swanson is liable to the estate for those. And I am going to demand here now on the record that Mr. Simon not negotiate any checks that are for the first year premium for policies written before the bankruptcy filing or nor renewal commissions for policies written before the bankruptcy filing, that he not negotiate any more of those checks. I believe they are bankruptcy estate property.

And I am saying this here because I want Mr. Simon to understand that too. Do you understand that, Mr. Simon?

A. No, I don't.

Q. I am telling you that you cannot negotiate those checks because I believe they are bankruptcy estate property. We may have a dispute about that, but that is what I am telling you right now.

. . .

MR. ANDRESEN: You are right. For now it is very clear to me that we need to agree with him that until the bankruptcy court orders otherwise or until you and I reach an agreement with him otherwise that money shouldn't be spent at all because we have to figure out, by getting an order from the bankruptcy court or reaching an agreement with Mr. Seaver that the money is or is not property of the bankruptcy estate.

While the question is raised by the trustee and he has taken the position that the money belongs to the bankruptcy estate the money can't be spent at all, we have to abide by what he is saying. Even though you don't like thinking about what he is saying we are talking about your daily income here, that money can't be spent until we figure out the question that the trustee is raising. That is the agreement he wants to come to. I am sure he is happy hearing me tell you don't spend the money.

MR. SEAVER: If you don't confirm to me right now on the record that you are going to abide by that –

THE WITNESS: I will abide by it, but I am not exactly what it is.

MR. SEAVER *(actually Mr. Andresen)*: He is about to tell you, he will get a court order right this minute or in a couple of days that forbids you from spending the money.

THE WITNESS: I will agree to do it, I am still uncertain what it is. You mean like in a few days here, in ten days or so when I get renewal commissions for the month of September from Centennial General, I cannot use that?

MR. SEAVER: That's exactly what I mean. At the –

MR. ANDRESEN: I believe he means starting right now until -- well, until years and years from now, whenever these commissions, renewal commissions that come to you that were written before the bankruptcy case was filed, he wants you to sit on that money and not spend it until we figure out this question.

MR. SEAVER: Well, more than that, that is part of it, Mr. Andresen, I think the prudent thing to do would be perhaps what we did in another case until there's a resolution, one of two things, pay it into your trust account or I put it in my trustee account for this case with the understanding that there is no resolution as to ultimate entitlement, it is just being held while we figure this out or while the court figures it out.

MR. ANDRESEN: Yes, I thin the use of your attorney trust account would be most appropriate for this, so language as we agree that the depositing of him putting the money into the attorney trust account wouldn't be in the bankruptcy estate.

. . .

MR. SEAVER: We are back on the record now, while we were off the record we talked about various things on those commissions. I indicated to Mr. Andresen and Mr. Simon for policies written after the bankruptcy was filed the state doesn't claim any interest in those policies. And we agreed, I believe, and I want Mr. Simon and Mr. Andresen to confirm this, that as to renewal commissions and first year commissions for all policies written prior to commencement of the bankruptcy case Mr. Simon, when he receives the direct deposit of premiums for those he will immediately, by immediately I mean that day, write a check payable to Randall L. Seaver, Simon trustee. I will deposit that check into my trustee account for this case, however, it will be without any prejudice to Mr. Simon's rights, defenses, arguments as to my entitlement or his entitlement to that money, it is not an admission of anything by Mr. Simon, it's merely a device by which we are going to hold the money pending resolution of this matter. I indicated to Mr. Andresen I would give him a letter saying these same things; is that accurate?

MR. ANDRESEN: That's accurate. Thanks for putting it on the record of we are establishing that him turning the funds over to you means that he is turning over the funds to your trust account and not turning it over to the bankruptcy estate so that he is not conceding the estate becomes owner of the funds.

MR. SEAVER: It will be go into my bankruptcy trustee account for this case, but he is not conceding to anything, it is kind of a convenience matter.

THE WITNESS: How am I going to survive? Can I get money out of my retirement account?

Rather than turning over any monies to the Chapter 7 Trustee, Debtor retained new counsel and on September 03, 2004 converted the case to a Chapter 13, despite the fact that all of the Debtor's pre-petition debts had been discharged on July 7, 2004.

The Debtor's new Schedule I states that he has gross monthly income of $2,675, far below his average actual gross monthly income from January - August, which exceeds $3,400.

The Debtor's plan claims that he has total unsecured debts of $77,170. Of course, the Debtor has received a discharge, so those debts have been discharged. The Debtor proposes to pay $115 per month on his plan for a total of $4,140, a total of approximately $700 in excess of a single month of pre-petition earned Commissions received by the Debtor post-petition.

Fuller, Seaver & Ramette, P.A. ("FSR") objects to confirmation of the plan and moves to reconvert the case to one under Chapter 7.

LEGAL ARGUMENT

A bankruptcy court may confirm a proposed Chapter 13 plan if the plan meets the standards set forth at 11 U.S.C. § 1325. Section 1325(a)(4), known as the Best Interest of Creditors Test, provides:

> Except as provided in subsection (b), the court shall confirm a plan if — (4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 if this title on such date;

11 U.S.C. § 1325(a)(4).

Under this section, the debtor must show that the Chapter 13 plan will provide a greater dividend to general unsecured creditors than a Chapter 7 liquidation would provide.

The Debtor's proposed Chapter 13 plan does not satisfy Section 1325(a)(4). The proposed Chapter 13 plan offers to pay $115 per month for 36 months, for a total of approximately $4,140 being available for distribution to creditors. Of that amount, $1,250 would go to Barbara May, his attorney, leaving less than $3,000 for other creditors.

According to the Affidavit of Randall L. Seaver, and the testimony of the Debtor himself, first year and renewal commissions on pre-petition policies have averaged over $3,400 per month. Since commencement of the Chapter 7 case, the Debtor has converted in excess of $21,000 of those non-exempt assets to his own personal use. Those assets were fraudulently concealed by the Debtor from the inception of the case until confronted by the Chapter 7 trustee at his Rule 2004 examination on September 22, 2000. Upon re-conversion of the case to one under Chapter 7, the Trustee would collect the monthly Commissions. Just one month of those Commissions would exceed the total amount the Debtor proposes to pay over 36 months under the plan. Further, the Chapter 7 Trustee would commence litigation against the Debtor seeking to recover from the Debtor in excess of $21,000 of estate assets which were concealed and converted by the Debtor post-petition to his own use.

The anticipated results of liquidation under chapter 7 are substantially better for creditors that what the Debtor proposes to pay creditors under his chapter 13 plan. Accordingly, the proposed Chapter 13 plan does not meet the best interest of creditors test and confirmation must be denied.

To be confirmable, a proposed Chapter 13 plan must have been proposed in "good faith." 11 U.S.C. § 1325(a)(3). The Eighth Circuit has defined "good faith" under Section 1325(a)(3) as follows:

> The bankruptcy court must look at factors such as whether the debtor has stated his debts and expenses accurately; whether he has made any fraudulent misrepresentation to mislead the bankruptcy court; or whether he has unfairly manipulated the Bankruptcy Code.

Education Assistance Corp. v. Zellner, 827 F.2d 1222, 1227 (8th Cir. 1987) (citing *In re Estus*, 695 F.2d 311(8th Cir. 1982). The Eighth Circuit later opined in *In re LeMaire*, 898 F.2d 1346, 1349 (8th Cir. 1990), that amendments to Section 1325 since *Estus* had incorporated several of the factors enumerated in *Estus*, and the definition of good faith provided in *Zellner* consisted of those factors not adopted into Section 1325(b). The Court in *LeMaire* held that the totality of circumstances test established in *Estus* was a valid test for good faith under Section 1325(a)(3). *LeMaire,* at 1349. Therefore, in *LeMaire*, the Eighth Circuit found that the following factors from *Estus*, in addition to the *Zellner* test, were particularly relevant to a determination of good faith: the type of debt to be discharged and whether the debt is nondischargeable in Chapter 7, and the debtor's motivation and sincerity in seeking Chapter 13 relief. *Id.*

The Debtor's motivation and sincerity in seeking Chapter 13 relief establishes his lack of good faith. This Debtor filed a fraudulent Schedule I and a fraudulent statement of financial affairs. He stated to this court and creditors that his gross monthly income was $1,000. See Schedule I. He stated that he had received only $2,500 in estimated gross income in as of the date of filing. See Statement of Financial Affairs, paragraph 1.

In truth, the Debtor was pocketing over $3,400 per month derived almost exclusively from commissions on Pre-Petition Policies.

This Debtor or his estate would have vested rights in the Continental General renewal and first commissions even if the Debtor was terminated or died.[1] Seaver Aff. Ex. 2 at Ex. 2 thereto at p. 000004. The bulk of the Debtor's commissions come from Continental General and Fidelity and Guaranty. Debtor 2004 Exam at p. 48, Seaver Aff. Ex. 2.

Commissions which are paid post-petition on pre-petition policies are generally held to be property of the bankruptcy estate because the services necessary to receive the commissions are rendered pre-petition. *In re Wu,* 173 B.R. 411 (BAP 9th Cir 1994); *In re Wicheff*, 215 B.R. 839 (BAP 6th Cir. 1998); *In re Swanson*, 2001WL 189 1379 (Bankr. D.N.D. 2001); *In re Bluman*, 125 B.R. 359 (Bankr. E.N.D.Y. 1991); *Williams v. Tomer*, 147 B.R. 461 (S.D. Ill 1992).

In addition to fraudulently understating his gross monthly income, the Debtor did not disclose at Schedule B his right to those Commissions on Pre-Petition Policies. Had the Debtor truthfully disclosed his monthly income and assets and turned those monies over to the Chapter 7 Trustee, the chapter 7 estate would have received in excess of $21,000. Instead, the Debtor simply converted those monies to his own use.

When the Chapter 7 Trustee obtained records by subpoena from the Debtor and conducted the examination of the Debtor confirming the existence of substantial undisclosed income and Chapter 7 estate assets, the Debtor retained new counsel and converted the case to

[1]The Debtor has not produced to the Trustee a copy of his contract with Fidelity and Guaranty Life.

a Chapter 13. That conversion took place only after the Trustee demanded that the Debtor cease using pre-petition assets to fund his living expenses.

1. The Debtor's plan is proposed in bad faith.

The Debtor filed false Schedules B and I in his Chapter 7 case. He concealed over $2,400 per month in gross income. He failed to disclose his right to commissions on Pre-Petition Policies. The Debtor received a discharge on July 7, 2004.

On September 22, 2004, at a Rule 2004 examination, the Trustee obtained testimony from the Debtor confirming the existence of the concealed assets, and confirming that the Debtor received substantial concealed gross monthly income. The Trustee advised the Debtor that he was not entitled to any of the Commissions, and that they were bankruptcy estate property.

Rather than complying with the Trustee's demand, the Debtor immediately switched attorneys, and in continuation of his scheme to mislead and defraud, filed a Chapter 13 plan purporting to provide a total payment of less than $3,000 on his already discharged debts.[2]

It is difficult to image a more blatant case of bad faith by a Debtor. This Debtor has already received a discharge. This Debtor has already converted to his own use over $21,000 from the Chapter 7 bankruptcy estate through his use of false schedules and a false statement of financial affairs. When confronted with his fraud and the demand upon him to cease taking estate property, he simply got a new attorney and converted the case to a Chapter 13. Chapter 13 should be reserved for those Debtors who are honest and sincere about filing a Chapter 13

[2]It should again be noted that the amount that the Debtor proposes to pay to unsecured creditors is less than the amount to be derived from the Chapter 7 Trustee's collection of one month of the commissions on pre-petition policies.

petition. Chapter 13 is not a haven for dishonest debtors who seek to avoid involuntary liquidation of concealed assets once those assets are discovered by the Chapter 7 trustee

Under the 8th Circuit's test for good faith under §1325(a)(3), the proposed plan of the Debtor is not confirmable and confirmation of the plan must be denied.

The court should convert this case back to chapter 7 for cause. A party in interest may move to convert a Chapter 13 case to a case under Chapter 7 for cause pursuant to 11 U.S.C. § 1307(c). The list provided under §1307(c) is not meant to be exhaustive. 8 LAWRENCE P. KING, COLLIER ON BANKRUPTCY ¶ 1307.04, at 1307-11 (15th ed. 1997). In this case, the debtor previously converted his chapter 7 case to one under chapter 13 pursuant to 11 U.S.C. § 706(a).

When a debtor has engaged in misconduct, courts have overwhelmingly rejected the argument that a debtor has a right to remain in Chapter 13 after his right to convert under Section 706(a) is exercised.

In *In re Jeffrey*, the bankruptcy court held that permitting the debtor to convert from Chapter 7 to Chapter 13 would abuse the bankruptcy process because of bad faith conduct on the part of the debtor. 176 B.R. 4, 6 (Bankr. D. Mass. 1994) (citing *In re Spencer*, 137 B.R. 506, 510-14 (Bankr. N.D. Okla. 1992); *In re Martin*, 880 F.2d 857, 859 (5th Cir. 1989); *In re Calder*, 93 B.R. 739, 740 (Bankr. D. Utah 1988)). In *Jeffrey*, the debtor hid assets from the estate which were discovered after a discharge had been entered:

> In this instance, conversion would constitute an abuse of the bankruptcy process, especially Chapter 7 and of § 706(a). A Chapter 7 case involves a *quid pro quo*: debtors receive a discharge and, in exchange, make full disclosure about their financial affairs, especially their assets, and surrender their nonexempt assets to the trustee for liquidation and distribution among creditors. 11 U.S.C. § 11 U.S.C. § 521(1) and (4), § 704(1), and § 726(a). In this case, the Debtors received

> the benefit of their Chapter 7 case — their discharge — but failed to disclose what appears to be their only assets of value to creditors. And now that that asset has been discovered, they want to take it into Chapter 13 with them."

Id. at 6; *see also Martin v. Martin (In re Martin),* 880 F.2d 857, 859 (5th Cir. 1989) (holding that the right to convert from Chapter 7 to Chapter 13 is an absolute right, and courts that have interfered with that right have only done so in extreme circumstances); *In re Calder,* 93 B.R. 739 (Bankr. D. Utah 1988) (holding that court could invoke § 105(a) powers to prevent debtor from exercising absolute right to convert from Chapter 7 to Chapter 13 in order to protect the bankruptcy system from an abuse of process); *In re Spencer,* 137 B.R. 506 (Bankr. N.D. Okla. 1992) (holding that a debtor can convert a case from Chapter 7 to Chapter 13 only in the absence of extreme circumstances amounting to bad faith); *In re Tardiff,* 145 B.R. 357, 360 (Bankr. D. Me. 1992) (holding that a court is not required to convert a Chapter 7 case to Chapter 13 under "absolute right" policy of § 707 if allowing conversion would "pervert, rather than to implement" congressional policy.).

The bankruptcy court in *In re Kilker,* analyzed the issue of bad faith and the absolute right to conversion in the context of the Eighth Circuit Court of Appeals' decisions on good faith. 155 B.R. 201 (Bankr. W.D. Ark. 1993). In *Kilker,* the Chapter 7 debtor moved to convert her case to one under Chapter 13 after a discharge in Chapter 7 was granted. *Id.* at 202. The United States opposed the motion to convert by asserting that the debtor was ineligible for Chapter 13 relief because the motion was filed in bad faith. *Id*. The United States also asserted that the debtor did not have regular income and was unable to submit a feasible plan. *Id*.

The bankruptcy court noted that the debtor had an absolute right to convert from Chapter 7 to Chapter 13 only if the debtor was "otherwise eligible for Chapter 13 relief." *Kilker,* 155

B.R. at 202 (citation omitted). The bankruptcy court then considered the factors for good faith set forth in *Handeen v. LeMaire (In re LeMaire),* 898 F.2d 1346 (8th Cir. 1990) (en banc):

> [W]hether the debtor has stated his debts and expenses accurately; whether he has made any fraudulent misrepresentation to mislead the bankruptcy court; or whether he has unfairly manipulated the Bankruptcy Code.

Kilker, 155 B.R. at 202 (quoting *LeMaire*, 898 F.2d at 1349). The bankruptcy court went on to note:

> The Eighth Circuit reaffirmed the "totality of the circumstances" test and set forth the "particularly relevant" factors to be applied in light of the purposes of Chapter 13:
>
> > The type of debt sought to be discharged and whether the debt is nondischargeable in Chapter 7, and the debtor's motivation and sincerity in seeking Chapter 13 relief.

Kilker, 155 B.R. at 202-03 (quoting *LeMaire*, 898 F.2d at 1349).

The *Kilker* court found that the debtor inaccurately stated her debts and expenses, attempted to mislead the court, and unfairly manipulated the Bankruptcy Code. 155 B.R. at 203. In that case, the debtor filed Chapter 13 after she learned her tax debt was not unsecured under Chapter 7 and thus, would not be discharged as the debtor had hoped. After the court so ruled, the debtor converted to Chapter 13. The court found that the information in the debtor's schedules changed in accordance with the type of relief sought. For example, in Chapter 7, the debtor listed zero income, but in Chapter 13, the debtor received commission income. The court noted that this changing source of income indicated fraud and a manipulation of the Bankruptcy Code. The court concluded:

> The blatant and fraudulent manipulation of information on the schedules to obtain a particular result is an unfair and insidious abuse of the bankruptcy process....In

> addition to the unfair manipulation of the Bankruptcy Code, the debtor failed to state her debts and expenses accurately and also made many fraudulent misrepresentations to mislead the bankruptcy court. *LeMaire*, at 1349. The debtor testified to numerous, material inaccuracies on her schedules. "

Id. at 204.

In this case, as in *Kilker*, the Debtor has already received a discharge, so it is clear he has no real motivation to pay now discharged debt.

Also, in this case, the debtor's original false schedules were compiled apparently with a specific intent to show that he did not have the ability make payments under a Chapter 13 plan. Specifically, he falsely stated that he had gross income of only $1,000 per month when, in fact, his gross income in the months immediately preceding his filing exceeded $3,800 per month. In other words, he falsely understated his gross monthly income by over $2,800 per month.[3]

Chapter 11 cases have followed a similar analysis regarding the improper conversion of cases between various chapters of the bankruptcy code. For example, in *Finney v. Smith (In re Finney),* the Fourth Circuit Court of Appeals opined that Section 706(a) granted the debtor a one time absolute right to convert a Chapter 7 case to Chapter 11 of the Bankruptcy Code and noted that most courts recognized this right "regardless of a debtor's recalcitrance or fraud." 992 F.2d 43, 44 (4th Cir. 1993) (citations omitted). However, the Fourth Circuit Court noted that "After recognizing [the debtor's] right to convert his case form Chapter 7, however, the district court

[3]It should further be noted that the Debtor's pattern of fraudulently understating his gross monthly income continues, as his Chapter 13 Schedule I states gross monthly income of $2,675. In fact, as evidenced by the Debtor's own checking account records, the average monthly gross income that he has received since this bankruptcy case was commenced, exceeds $3,487. The Debtor's Chapter 13 Schedule I is simply a continuation of his fraudulent scheme.

observed that he had no subsequent right to *remain* in Chapter 11." *Id*. at 45; *see also Finney v. Smith,* 141 B.R. 94, 98 (E.D. Va. 1992) ("Even if the debtor does have an absolute right to convert his case from one chapter to another, however, he does not necessarily have the right to keep it in a particular chapter."); *Texas Extrusion Corp. V. Lockheed Corp (In re Texas Extrusion Corp.),* 844 F.2d 1142, 1161 (5th Cir. 1988); *In re McNallen,* 197 B.R.. 215, 219 (Bankr. E.D. Va. 1995). See also, *In re Bowman,* 181 B.R. 836, (Bankr. D. Md. 1995) (holding in a chapter 11 case that a debtor had absolute right to convert pursuant to § 706(a) unless egregious circumstances exist).

The court should grant FSR's request to reconvert the case to chapter 7 pursuant to Section 1307(c). The debtor has converted this case to one under Chapter 13, and therefore, has exercised his absolute right to convert. The Court should recognize the authority cited above, which provides that a debtor acting in bad faith should not be permitted to remain in Chapter 13. Since a debtor acting in bad faith cannot have a Chapter 13 plan confirmed pursuant to Section 1325(a)(3), this case should be converted for cause to Chapter 7 pursuant to Section 1307(c).

CONCLUSION

Because of the Debtor's bad faith, plan confirmation should be denied and the case should be reconverted to Chapter 7.

FULLER, SEAVER & RAMETTE, P.A.

Dated: October 29, 2004

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